Okay? So, now -- you know, Prof. Coffee comes in here and sort of pronounces *ex cathedra* this is not classic, because it is costless exercise. Well, you know, I'm -- where is this, you know? The -- it is not costless. We have -- it's a prepaid option. We've paid fair market value for this right.

There's nothing that says that a prepaid option is any less an option. He says it's riskless. Well, we've showed it's not riskless. But the hallmark of an option doesn't depend on whether or not at any given time you could lose a lot of money or not. A vested, in-the-money option doesn't become a non-option. So --

MS. MIKES: But let's just --

MR. BIRD: -- there's notions that -- you know, that contingency and -- there is a contingency here that makes it more contingent than an option normally is.

MR. BRADSHAW: And Johana, on the issue of control, which I think is really what underlies much of Prof. Coffee's policy-oriented concern about options and the other statutory schemes in which he draws for precedent on options and the concerns about options, have to do with an asserted capacity to influence because you hold the option. And it's sort of the starting point for his five factors of control.

What I think is critically important there is the

immediacy of that potential control. And here, with the condition precedent of getting through the 271 process before Bell Atlantic and GTE can exercise and take control of Data Co. necessarily means that it is going to be more remote and uncertain as to when or whether Bell Atlantic-GTE will actually exercise that option and come in and take control.

The idea of control or influence for our benefit is necessarily option holder-specific. And so it's inconsistent with that, that we may have a free right to sell it and, therefore, may not, in fact, ever be Bell Atlantic and GTE that exercises the option. Maybe somebody else. So that it's not a certainty that it will be this company.

Then, furthermore, because of the condition precedent of the 271 approval, it's uncertain as to when. And I think that's critically important, because in the rule 13(d) context that they've cited from the securities laws -- that has to do with options that are immediately exercisable within 60 days or some other concept of influence. And here we don't have that kind of option, because GTE and Bell Atlantic cannot take control within 60 days, cannot exercise the option.

MR. COFFEE: Can we get this fact clarified? Because there's a basic disagreement about what they've said

previously. If you'll just look at page 31 of their initial submission, which is what we're relying on, their words -- their January 27th brief, they say that in the event they fail to get interlata approval -- which they're now saying is the condition precedent -- they can exercise anyway and sell the Class A shares.

That, to me, means you can exercise. And I believe that's legally --

MR. BARR: But control has to go to a certain holder. If you sell it to somebody else, we're not -- you know, who's going to be --

MR. COFFEE: I'd like to point out what you've said in the past. And maybe you're going to back off now --

MR. BARR: No, no, no, no. This is where you're having your cake and eat it to, because you're saying that this can be immediately translatable into value, which raises an issue of incentives. But then you're trying to bootstrap that into the issue of the immediacy of its exercise as the control. But control has to go to who the holder is.

MS. MIKES: I understand that control goes to who the holder is, but I don't understand that ownership does. If -- let's assume, *arguendo*, that we have an instrument that is 100 percent going to be converted. There's -- it's in everybody's economic interest that it will be converted.

Why does it matter who that holder is? Or does -- I mean does it?

MR. BARR: For -- no, but we're -- what I'm saying is if that is an optional right, then, you know, the black-letter law rule is that I don't own the equity yet -- until I exercise.

MR. BRADSHAW: You can construct immediacy --

MR. BARR: What he's saying is the fact that a -- you know, something's becoming less contingent and you can expect it will -- and you have the right to immediately exercise it doesn't make it ownership. He's wrong.

MR. COFFEE: Now, look. Let's --

MR. BARR: Okay? But it may --

MR. COFFEE: -- talk about what you're saying.

MR. BARR: -- raise an issue -- it may raise an issue of control, which is what occurred in the (e)(d) context, which is things that become immediately exercisable within a period of --

MR. COFFEE: -- I don't think you have yet cleared the point that we're making. They have previously said even if they cannot get interlata approval -- 271 approval -- they can do one of two things. They can sell the option to a new holder; or, they can exercise their conversion right, transfer the B into Class A shares, and then sell the Class A shares without getting FCC approval.

My understanding -- and I'll have Peter confirm this -- is that that is really their legal power, because there is not a precondition of FCC approval to exercising the conversion right. There is only a precondition of FCC approval to offering long distance services -- so that you could for a day not offer these services, convert and the sell the Class A shares. This is something that is currently convertible.

So, even if you were to look at the misleading interpretation they have of 13(d)(3), this is currently convertible. All you cannot do is engage in certain services in some states during the period which you have not yet secured FCC approval.

MR. BRADSHAW: The question for control is whether the option -- whatever rights and conversion rights it carries -- indirectly creates control by virtue of the influence it will have over the management of the business.

MR. KEISLER: Right --

MR. BRADSHAW: The concept of control can't be divorced from the purposes of the statute here, and the purposes of the statute are to prevent the Bell company from participating -- i.e., controlling -- the provision of interlata service by another company until it's authorized to do so.

So, the question has to be does the option right

and the conversion right of Bell Atlantic create such an overpowering impetus that the management team of Data Co will provide long distance service just the way we want it to do, so they'll preposition customers for us. And the condition precedent on exercise and the fact that it is uncertain that we will actually get that control -- if we will be the ones to take over the business -- means it is remote, at best that there would ever be that indirect influence.

MR. KEISLER: There's a fundamental confusion here between the parties. We're talking about two different things, I think. I think I can cut from this. They're talking about ownership. They're talking about control. That's what Steve was just talking about. We're talking about ownership. The reason this came up is that they asserted that they wouldn't be beneficial owners of the underlying securities under SEC rules, because they can't convert it instantly. They can only convert it within -- you know, once they get interlateral relief.

MR. BARR: That's not our position.

MR. BRADSHAW: First of all, the Commission in the (e)(d) rule context, in the footnote 329 expressly rejected the notion that just because it's a convertible interest within 60 days it's ownership. In fact, they rejected the argument that Time Warner was making that it was the

equivalent of an equity interest under --

MR. KEISLER: I'm addressing a very --

MR. BRADSHAW: -- section 31.

MR. KEISLER: -- specific point. I'm addressing a very specific point that GTE made. They said, "We would not be beneficial owners of the underlying security under the SEC's beneficial ownership rule." They said, "We would not be beneficial owners, because we can't exercise this option within 60 days."

There are two fundamental problems with that. First, they can exercise the -- what they call the option on the first day. They may not provide service through the assets, but they can exercise the option.

MR. BARR: Excuse me. What we're proposing in a general exhibit is we can exercise as part of a transaction whereby we immediately divest those shares.

MR. KEISLER: That's an exercise.

MR. BARR: Well, for purposes of control --

MR. KEISLER: I'm not talking about control.

MR. BARR: Well, control --

MR. KEISLER: We're talking about whether --

MR. BARR: With all due respect, Peter --

MR. KEISLER: -- these are, under the beneficial --

MR. BARR: -- rule 13(b) --

MR. KEISLER: -- ownership rule --

MR. BARR: -- and the beneficial ownership concept is a concept of influence. It's based on a concept of influence.

MR. KEISLER: This is 13(b). There are three different ways under 13(b) in which they are beneficial owners of this underlying security. We're talking about one of them, which is that they can exercise within 60 days.

I think the professor -- this is Prof. Coffee's field, not mine; but maybe it would be worthwhile just to, you know, bring this particular debate -- this part of the debate to the point for Prof. Coffee to walk through 13(b) and just explain the three different, independent ways in which they will be beneficial owners.

MR. COFFEE: Okay. I don't have the rule in front of me, but the three ways --

(Laughter.)

MR. COFFEE: No, I know the rule. The first way we were -- we're endlessly debating -- look down to clause D(1)(i). And when you get to that, you'll find a "provided, however" clause.

That "provided, however" clause midway down says that even if this option is not convertible within 60 days, any person who acquires a security or a power specified in a, b or c -- which is a conversion right, option right or

any other kind of legal right to convert -- then, if you acquire that, even though it's not exercisable for the next 60 days -- if you acquire it with the purpose or effect of changing or influencing the control of the issuer.

Influencing the control of the issuer is explained in the SEC releases adopting this as meaning anything that could even block others. It's got a very broad release clause. This is a right to get 10 percent elevated into 80 percent, and that has to influence the control of the issuer. And I think I can show you SEC releases that have read it that way and said that overcomes anything else in d(1)(i).

The second way -- let me look through all three.

MR. GILSON: Put it into context. Let's keep in mind what section 13(d) does. If 13(d) is triggered, the effect of it is to require a disclosure --

MR. COFFEE: Just a second, Ron. We didn't raise 13(d). Bell Atlantic did. This was your last point in your last submission, and you're arguing that 13(d)(3) proves something. And we're saying whatever it might prove, it cuts our way -- because for three, independent reasons.

This rule, just like the 16(d) rules that you raised earlier, actually say that Bell Atlantic has beneficial ownership right away. One reason is this "provided, however" clause that says if you -- getting an

option or conversion right will allow you to influence control. And a 70 percent increment does that, and the SEC release is interpreting this to say that, that's one reason.

Another reason is, this is immediately convertible. There is no 60-day delay because, as they've acknowledged in their earliest filing at page 31, they have the right to convert the Class B shares into Class A shares and sell. All they can't do is offer interlata services during that period which they hold the Class A shares.

A third reason is, if you actually read this rule fully and the releases, d(1) is not an exception; it's an additional category. It doesn't say you're exempted.

D(1)(i) says a person shall be deemed to be the beneficial holder of a security, including an option, in the event that it's exercisable within 60 days. That's an additional category.

The basic category that makes you the holder of control here and makes you a beneficial holder is the investment power category up at subsection (a). Subsection (a) says, "Anyone who holds either the voting power" -- which you do not hold for the Class A shares -- "or the investment power, which includes the power to dispose or direct the disposition of the underlying security."

You have the power in selling this option to direct immediately -- immediately convertible -- the

disposition of the underlying security, because you can sell your Class B shares tomorrow to AOL, Time Warner, Microsoft or whoever, and that -- thereby direct the immediate disposition, because they can exercise one second later, just as you could also.

Those are three distinct reasons just dealing with his one issue. If you raise 13(d)(3), it cuts our way, because it says for all these reasons 13(d)(3) makes you the beneficial holder.

MR. GILSON: The (e)(d) rule was raised by you to suggest that this -- that options that were immediately exercisable should be treated as ownership. We pointed out that the Commission rejected that and said, No, even options that were immediately exercisable -- we're not going to treat as ownership. They may raise a control issue, and we may count them against that backdrop.

But that's how 13(d) came up. These other things were not --

MR. COFFEE: But you have just stated in the forum also that it's immediately exercisable to these beneficial owners.

MR. GILSON: But the concept of beneficial ownership under 13(b), one, it's a different statute in its disclosure purposes. It would be a little nonsensical to interpret your statute in light of that statute with those

purposes.

But, number two, the purpose of the beneficial ownership concept under 13(d) is influence. We cited on page 19 of our latest submission for Monday in footnote 28 the interpretive release. "Rule 13(d)(3) emphasizes the ability to control or influence the voting or disposition of securities."

In fact, it's not just influence of the company; it's influence of the voting or disposition of securities. And then, moreover, in the source we cited, footnote 29, they talk about this concept. They explain it. "The Commission is mindful that as the point in time at which" -- that's the Securities and Exchange Commission -- "the point in time at which the right to acquire may come to fruition is extended into the future, the rights, ability to influence control is correspondingly attenuated."

And then we also cite cases that say where you have to go through a regulatory hurdle before you can exercise that control, it doesn't count within the 60-day rule, no exercise.

So, it's an irrelevant statutory scheme. Second, the Commission addressed it specifically in the cable attribution rule order, and said, "It's not ownership even if it might be counted as ownership for securities purposes. We're not going to count it as ownership here ."

MR. KEISLER: We were addressing specifically Time Warner's assertion about the 60-day rule.

MR. GILSON: Right.

MR. KEISLER: But then the second and third sentence were intended to encompass any other type of equity interest that you could ever imagine.

MR. GILSON: Right.

MR. KEISLER: And that, in a sense --

MR. GILSON: For purposes of the (e)(d) exception.

MR. KEISLER: Without exception to when the option was convertible.

MR. COFFEE: Yes. And you can see that from the footnote, was what -- what they all wrote was, Time Warner argues that options, warrants and subordinated debentures should generally -- the word "generally" -- be treated as trivial interests, because the SEC treats them as trivial when they're 60 days. We don't want to treat them as trivial unless they add up to more than 33 percent -- as, of course, this one does, because it adds up to 80 percent.

Bill says this is only about control -- that the (e)(d) rule is only about control. The notice of proposed rule making and the cable attribution proceeding -- second sentence -- "The attribution rule seeks to identify those corporate, financial, partnership, ownership and other business relationship that confer on their holders a degree

of ownership or other economic interest, or influence, or control over an entity engaged in the provision of communication services such that the holder should be subject to the Commission's regulation."

And, finally, there has been something of a pattern in the back and forth over the briefing, which is whether it's the securities law, rule 144, the Commission's (e)(d) rule. They cite something and say it proves that what -- that their instrument would not confer ownership or control. We show that it proves the opposite, whether it's the securities laws or the Commission's rules. And then they come in and say, as Prof. Gilson is starting to, "Well, that's distinguishable. That's not relevant. That's a different purpose."

You know, you are allowed to argue in the alternative, but there have to be limits to saying, "This supports us, but if it doesn't it's irrelevant."

MR. GILSON: That is a comment that I do claim personal privilege to respond to. The one thing I agree with what the gentleman has just said was his reading of the scope of the rule making proceeding. What he said was that there was an inquiry with respect to ownership and control for purposes of the Federal Communications Act.

And the position I've taken in three submissions from the beginning and that the -- not just the risk, but

the intention and the fact of marginalizing both Jack and I -- is that a litany of different statutory schemes, each of which treats option in a different fashion, each of which fashion relates to the statute's own purpose, adds nothing to the determination which the gentleman indicated -- then talking about that was the focus of the investigation. That is, how does it work under the Federal Communications Act?

So, Jack and I can debate the reading of a particular chancery court hearing or in what circumstance the bankruptcy court treats options as real, what circumstance they look through it, or which of the 15 different ways the tax laws treat options -- in one circumstance is that they're real, and in other circumstances is they look through it. That debate, each of which relates to the purposes of a particular statute, doesn't help resolve the issue with respect to the purposes of this statute.

Now, people can disagree with my declaration. In the end, the thrust was for the purposes of this statute, the impact of this option is a function of the purposes of section 271. That may be right, that may be wrong. The gentleman is free to disagree with that.

But as much as Jack and I know about a myriad of alternative statutory structures that treat options, each of them differently in each of those structures -- some

consistent with the view we've expressed, some consistent with the view Jack expressed -- it really doesn't help you with respect to the Communications Act. Now, perhaps I simply marginalized what I can bring to this, but --

MS. MIKES: Can I ask you --

MR. GILSON: Sure.

MS. MIKES: -- a very specific question?

MR. GILSON: Yes.

MS. MIKES: I understand your point about other statutes in general. But with respect to this deal, is the treatment for accounting and tax purposes of what Verizon -- how Verizon is going to treat this deal for accounting and tax purposes -- should that illuminate our interpretation of this deal?

MR. GILSON: It would depend on the particular treatment. For example, the treatment of -- the calculation of NewCo's earnings per share under -- after this transaction, under APBATT will typically turn on -- and here recognize this is my knowledge about accounting; I don't hold myself as an accountant -- will turn, for example on whether NewCo has the ability to influence the outcome, influence the decisions of Data Co.

So, APBATT, which the independent accountants have to sign off on, if they can, then APBATT isn't a choice. Then they have to account for it that way. My understanding

is that NewCo will not account for this interest, will not account for this -- for the Data Co. interest under APBATT.

So, that I mean to that extent, it's consistent -- though I have not looked at accounting -- the myriad of other accounting rules that affect this. So that at least with respect to the accounting rule that I know and which goes directly to ability to influence, my understanding is that NewCo will treat this transaction consistently -- that is as if it did not have the ability to influence it.

And as a result, 80 percent will not run through NewCo's earnings per share. And they're --

MS. MIKES: Then --

MR. GILSON: -- closer to the transaction -- you can correct me, but I believe that to be both the accounting issue as well as their intention about how the transaction will be accounted for.

MR. STRICKLING: You -- before we got into this last question, we were talking about how these other statutes we can look at are merely reference points and may or may not be controlling here. I -- John's been here all afternoon, and I'm just wondering -- we do have a body of unanswered --

(Laughter.)

MR. THORNE: Do I have an answer to that answer to which you have a question?

(Laughter.)

MR. STRICKLING: You may be more instructive -- and we haven't talked about it this afternoon -- which is the MFJ precedent. I guess I've got three questions for you, John and then, Peter, you can answer them, as well. Number one: To what extent is that precedent controlling? Number two: To what extent is it instructive? And, number three: Assuming it's either or one of those, what's the outcome? In other words, how would you apply the MFJ precedent to this proposal?

MR. THORNE: There was a point earlier where you mentioned -- I mean, I am going to get an answer to one of your earlier questions, as well, as part of this. You asked -- we interpret 3-1

MR. STRICKLING: You get no extra credit for that.

(Laughter.)

MR. THORNE: Do we interpret 3-1 in a deal-specific way? I think the answer is no, you don't interpret it in a deal-specific way. But you certainly imply it deal-specific. And when you asked that question, I remembered the Judge Green regime, where Green sent the Justice Department off to look, deal by deal, at options with the guidance that they should be really contingent -- meaning you couldn't get into the business until you have the waiver relief, sometimes long distance waivers and, second, that

there shouldn't be a real risk of discrimination.

And then the Justice Department went off and looked deal by deal and developed a body of precedent -- some of them on long distance, some on manufacturing, some on other similar kinds of line of business restrictions.

I guess I would say that corpus of law is instructive. It's not controlling, I think, because the -- you know, the Act abolished Green. But if anybody in the world -- the Court Reporter will notice there's a word missing there -- abolished Green's regime. But if there's anyone in the world who was vigorous at policing the restrictions, even creating, you know, in my view at the time, a fence around this restriction to make sure there were no accidental circumventions or incursions, it was Green.

And Green said that options in cases like -- pretty much like this case were permitted. And I would think the Commission would be free to take that as a reference point that, you know, grows out of the same restriction that was then put in this statute.

You know, a lot of the specific Green decisions which have been briefed here seem on point to some of the things Prof. Coffee said. There was an example where SBC had found itself accidentally in the manufacturing business, had to divest a current equity interest, turned it into an

option. The Justice Department approved that.

There were a number of -- I think they're mostly Ameritech options that were transferrable after a period of years. The idea was if the Bell Company was unable to get the waiver relief necessary to exercise the option, they should be free to exit the option.

I think the argument that was accepted both at the Justice Department and at least implicitly by Green was exiting the position ensured there'd never be a -- you know, a conversion and a participation.

MR. STRICKLING: What about a buyout of the investment, though? I mean I think the first case in the area, Tel-OptiK -- Green pointed out, you know, one of the factors being whether or not the size of the investment was relatively minor -- and I don't know; minor compared to what -- but --

MR. BARR: It was minor compared to the revenue and the size of Bell.

MR. BRADSHAW: Yeah, it was the size of the investment relative to the overall revenues of the Bell Company. Here, the investment that GTE has in Internetworking is under $2 billion. It's about a $1.7 billion book value being transferred, and the overall revenues of the combined companies are about 60 billion. So, there is --

MR. THORNE: Given the inflation of the Internet age, this probably fits within what Green would have thought of as a minor investment in the total scheme. In fact, that's another way you can distinguish this from deals down the road.

MR. STRICKLING: I mean there aren't too many of us in the room who are veterans of those wars, but it's hard to imagine Green approving a $2 million, in fact, prepaid option on a --

MR. THORNE: He did. He did approve a number of prepaid options. He approved a number of transferrable options. All the options, as far as I can remember, were fixed-price -- meaning there was an opportunity for some appreciation based on the --

MR. STRICKLING: The appreciation --

MR. BRADSHAW: He was also dealing with a statute that defined "affiliated enterprise," in fact, more broadly than the concept of affiliate, and had no *de minimis* exception for a 10 percent ownership interest. You couldn't own --

MR. STRICKLING: There was one that, in fact, grafted of five percent though.

MR. THORNE: DOJ sometimes said that, but I don't --

MR. BRADSHAW: I don't think he ever --

MR. THORNE: -- think Green ever resisted the opportunity to bless DOJ's blessing.

MR. STRICKLING: Peter?

MR. KEISLER: Yeah. We argued in the Qwest case that DOJ was controlling. He told us, no, not controlling; but instructive. So, I sort of accept that framework for discussing this.

I think it's instructive in three respects, two positive and one negative. First, on a general level, Bill was talking earlier about how the concern of 271 is to make sure the company can't operate on two levels at once. And I took him to be reiterating what Prof. Gilson had said, which is that 271 is about service bundling. You can't bundle services together. If you can't do that, you're not violating 271.

I was suggesting in my colloquy with Dorothy that is certainly one purpose of 271, but that there was also this whole feature of 271 which is until the BOCs' monopolies are open, they have the capacity to discriminate in other ways -- through technical discrimination, interconnection access -- things like that -- against long distance carriers; and that that was something that they would have an incentive to do if they had a stake in a particular long distance carrier.

That was obviously central to the MFJ. And the

D.C. Circuit has held that those findings and reasons were incorporated into 271. They held that in the bill of attainder cases that Chris argued, because Chris in his briefs and while arguing had to explain, you know, why 271 served a nonpunitive purpose. Here was the regulatory purpose it served. And one of the things the Commission said in its briefs, and the courts adopted in their -- the court adopted in its decision, was you are incorporating -- the Congress was incorporating the findings under the MFJ.

So, I think certainly the D.C. Circuit and the FCC and everyone has accepted the fact that one of the purposes of 271 is not simply about service bundling, but about discrimination against long distance carriers.

Second thing: with respect to the three-part test, I think -- you know, John has talked about all the options that Judge Green has proved. What it really was, was Judge Green set out this three-part in the Tel-OptiK case, but after that everything went to the Justice Department.

And there were challenges that came back to Judge Green. He never really passed on them, so I don't think you can get much out of the fact that essentially Judge Green was such a hawk that, my God, if he approved it, must have been okay. The examples we're talking about are not Judge Green examples. They didn't -- he never -- you know, things

languished before him for a long time, and then were sort of -- were mooted when the decree was vacated --

MR. THORNE: Peter, you got to give yourself some credit. The Sidley firm for AT&T argued to Green and to the Justice Department that a transferrable option, where the option was at a fixed price -- there would be an opportunity for appreciation -- would create the same kinds of risks. And Justice, with no challenge from Green -- it was all briefed to Green -- said that was fine. That did not create an unacceptable risk, that --

MR. BRADSHAW: In fact, the argument was that it would create a, quote, "immediate equity interest," close quote. And that argument was rejected.

MR. THORNE: Rejected.

MR. BRADSHAW: No, on the point of --

MR. KEISLER: I -- they may have said that. They may have not. I haven't talked to him about that.

But the three-part test that Judge Green adopted, the first step was -- as you said, Larry, besides the investment. This SBC investment you're talking about was $1.5 million. I'm sure whatever that is in relation to SBC, it is dwarfed by the relationship of Genuity to GTE.

The second test was is there a genuine contingency here. And I suppose we can debate this. I don't think there's a genuine contingency; that if Bell Atlantic wants